IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No.

VIRGINIA NATIONAL BANK,

Petitioner

v.

UNITED STATES OF AMERICA,

Respondent

PETITION OF VIRGINIA NATIONAL BANK FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

T. HOWARD SPAINHOUR
2030 Virginia National Bank Building
Norfolk, Virginia 23510

Attorney for Petitioner

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-styled case on November 15, 1971.

OPINIONS BELOW

The opinion of the United States District Court for the Eastern District of Virginia, Norfolk Division, John A. MacKenzie, Judge, a copy of which is appended hereto, is reported at 321 F. Supp. 316 (1970).

A copy of the opinion of the United States Court of Appeals for the Fourth Circuit, which has not yet been reported, is appended hereto.

JURISDICTION TO REVIEW

The jurisdiction of this Court is invoked under Section 1254(1) of Title 28 of the United States Code [28 U.S.C. § 1254(1)], on the grounds that the Court of Appeals has not only decided an important question of Federal law which has not been, but should be, settled by this Court, but also has decided said question in a way which is in direct conflict with applicable decisions of this Court (or, if not so in conflict, said decision has, in effect, declared invalid a taxing statute of the State of Virginia). The date and time of entry of the judgment of the Court of Appeals sought to be reviewed is November 15, 1971. An order denying petitioner's request for a rehearing was entered by said Court of Appeals on December 15, 1971.

QUESTIONS PRESENTED

Whether petitioner is entitled, as it contends, in determining its federal income tax liabilities for the years concerned, to deduct, as a tax under Section 164(a) and Section 164(e) of the Internal Revenue Code of 1954, as amended (the "IRC") or as a business expense under Section 162(a) of the IRC, certain payments, made pursuant to the requirements of the tax laws of the State of Virginia, to institutions which were exempt from state property taxation and life insurance companies which were exempt from state intangibles taxes because subject to state tax on gross premium income (all such institutions being defined in the Virginia taxing statute as, and herein sometimes referred to as, "exempt institutions"), which were (or had been) shareholders of the petitioner, or whether such payments were, as the respondent has contended, nondeductible dividends or other distributions with respect to the petitioner's stock.

RELEVANT STATUTES

The Federal statutory provisions which are involved in this case are contained in Sections 162(a), 164(a), 164(e), 301(a) and 316(a) of the Internal Revenue Code of 1954 [26 U.S.C. § 162(a), Vol. 6, p. 6364; 26 U.S.C. § 164(a), Vo 6, p. 6369;

26 U.S.C. § 164(e), Vol. 6, p. 6370; 26 U.S.C. § 301(a), Vol. 6, p. 6436; and 26 U.S.C. § 316(a), Vol. 6, p. 6450] and Section 548 of Title 12 of the United States Code (Revised Statutes, Section 5219; 12 U.S.C. § 548; Vol. 3, p. 2378); as in effect during the years involved, the full text of each of which is set out in the appendix hereto.

The provisions of the Income Tax Regulations involved are Sections 1.162-1(a), 1.164-1, 1.164-3 through paragraph (a) thereof, 1.164-7, 1.301-1 through paragraph (c) thereof and 1.316-1(a)(1) [26 CFR §§ 1.162-1(a), 1.164-1, 1.164-3, 1.164-7, 1.301-1(c) and 1.316-1(a)(1)] the full text of each of which is set out in the appendix hereto.

The provisions of the Virginia statutes which are involved are contained in Chapter 10 of Title 58 (Sections 58-465 et seq.) of the Code of Virginia of 1950 as amended (the "Virginia Code") specifically Sections 58-465, 58-466, 58-470, 58-473 and 58-480, as in effect prior to June 26, 1964, and Section 58-473 and Sections 58-465.2 and 58-480.1 of the Virginia Code as amended and added at the 1964 Session of the Virginia General Assembly, effective on June 26, 1964, the full text of said Chapter and of each of said amended and added Sections being set out in the appendix hereto.

STATEMENT OF THE CASE

The petitioner is a national bank having its principal office in and doing business in the State of Virginia. As the one tax permitted to it by Section 548 of Title 12 of the United States Code (12 U.S.C. § 548; Revised Statutes, Section 5219), the State of Virginia has elected to impose a tax upon the shares of national banking associations located within its limits.

Prior to June 26, 1964, the effective date of the amendments enacted at the 1964 session of the Virginia General Assembly, the state taxing statute contained no express provision relating to shares of banks owned by exempt institutions. However, pursuant to, and since, a 1928 decision

of the Supreme Court of Appeals of Virginia, the State of Virginia has, taking into account other pertinent Virginia constitutional and statutory provisions, taken the position that exempt institutions are entitled to refund to them of any tax paid by a bank with respect to shares owned by such exempt institutions, and has permitted and encouraged banks, in lieu of remitting the tax on such shares to the state, to remit the same amount directly to the exempt institutions concerned and to reduce the amount paid to the state by the amounts so directly paid. If any bank did not make direct remittances to exempt institutions, the State required that the tax on all shares be paid to the State. After June 26, 1964 the state taxing statute was amended to make mandatory such direct payments to exempt institutions.

During all the years involved in this case, the state taxing statute required that each bank make a return, as of the first day of January of each year, and file such return on or before the first day of February of such year with the Commissioner of Revenue of the county or city in which the bank was located. Each bank was required to pay to the state [tax payments made to cities, towns and counties pursuant to said Virginia statute being treated herein as paid to the state], on or before the first day of June of each year, the state tax at the rate of One Dollar ($1.00) on each One Hundred Dollars ($100) of the value of its stock, except that prior to June 26, 1964, each bank was permitted, and after said date required, to make payments directly to such exempt institutions which had owned shares on January 1 of the year involved, at the aforesaid rate, and to reduce the payment to the state by the amounts so directly paid.

In accordance with the Virginia law, the petitioner made the following payments:

	To the State	To Exempt Institutions
1963	$151,584.77	$ 5,629.95
1964	300,846.20	6,148.30

1965	317,286.48	11,421.46
1966	364,712.92	13,637.74

The petitioner made all such payments from amounts accrued and designated as its tax accounts, its Board of Directors never declared a dividend or took any other action with respect to the aforesaid payments; and no exempt institution or other shareholder ever reimbursed the petitioner for any amounts paid under the said Virginia statute. The Virginia taxing statute provides to each bank the right to recover from each shareholder other than an exempt institution the amount paid with respect to such shareholder's shares but does not provide for any right of recovery of payments to exempt institutions. In determining the petitioner's federal income tax liabilities for the years concerned, the petitioner deducted all the payments made as required by the Virginia law. The respondent allowed such deductions for the amounts paid to the state but disallowed deductions for the amounts paid directly to exempt institutions and collected additional federal income taxes on account thereof.

On July 17, 1969, the petitioner brought suit in the United States District Court for the Eastern District of Virginia, Norfolk Division, for refund of federal income taxes and assessed interest thereon in the aggregate amount of Forty-Four Thousand Five Hundred Ninety-Eight Dollars ($44,598.00), which had been collected by the respondent from the petitioner as additional federal income taxes for 1963, 1964, 1965 and 1966, invoking the jurisdiction of said District Court under 28 U.S.C. Sections 1340, 1346(a)(1) and 1402. Said suit originally involved three separate issues but prior to trial the respondent conceded two of said issues, leaving for decision by the District Court only the issue herein presented. With respect to said issue, the petitioner claimed that the payments involved were deductible under Section 162(a) of the IRC as ordinary and necessary business expenses and also under Section 164(a) and (c) of said Code as taxes, while the respondent claimed that the payments were non-deductible dividends or other distributions by

the petitioner to its exempt institution shareholders with respect to petitioner's stock owned by them.

The issue was tried in the District Court, without a jury, upon the pleadings and stipulations of the parties, including depositions, and judgment was awarded to the petitioner in the amount sued for. Of the total amount of said judgment, approximately Twenty-Three Thousand Nine Hundred Twenty Dollars ($23,920.00) (just over 53%) related to the conceded issues and approximately Twenty Thousand Six Hundred Seventy-Eight Dollars ($20,678.00) (something over 46%) related to the issue now presented herein.

The District Court held that the payments in issue were ordinary and necessary business expenses incurred in the carrying on of its banking business and deductible under Section 162(a) of the IRC.

Upon request by the respondent that the District Court also make a finding on whether the payments were a tax, or not, under the appropriate parts of Section 164 of the IRC, the District Court held that such payments were taxes in the context of the facts of this case and were also deductible as such under said Section 164.

On appeal, in a divided opinion, Judge Winter dissenting, the Court of Appeals held that the payments fit the statutory definition of dividends, that the payments were in substance dividends required by state law to be paid by a national bank, and that the payments were not deductible under any provision of the IRC in determining the petitioner's federal income taxes, and, accordingly, reversed the decision of the District Court.

ARGUMENT

The majority opinion of the Court of Appeals reflects an almost complete disregard or lack of understanding of the interplay of the various provisions of the IRC, inter se, as well as a failure to take into account the significance and effect of other

state and federal laws and a failure to abide by the decisions of this Court concerning the IRC and other controlling federal law. The Court of Appeals disregarded the fact that the payments in issue fit every definitional requirements of law as ordinary and necessary business expenses and also as taxes, deemed it wholly immaterial that such payments were compelled by the State of Virginia in its taxing statutes, ignored the numerous decisions of this Court to the effect that neither the State of Virginia nor any other state has any power to impose any obligation upon a national bank other than a tax as permitted by express federal law, and based its decision entirely on Sections 301 (which provides only for the tax effects upon a *recipient* of property distributed by a corporation to its shareholders with respect to its stock) and 316 (which defines a dividend) of the IRC, and upon some wholly unwarranted and immaterial assumptions and reasoning with respect to Virginia law and the purpose and effect of the Virginia taxing statute. In arriving at its conclusions, the Court of Appeals, as is apparent in the first footnote to its opinion, entirely disregarded the last sentence of Section 164(a) of the IRC which had been cited to it by the petitioner as authority for its position, and as the basis for its decision the Court used certain illustrations and reasoning which give no more support to its own decision than to the opposite decision of the District Court.

There are involved here important questions of federal income tax law which have not been, but should be, settled by this Court. This Court has on some occasions addressed itself to the question of whether a particular payment is or is not an ordinary and necessary business expense within the meaning of Section 162(a) of the IRC (and similar provisions of prior law), e.g., *Welch* v. *Helvering*, 290 U.S. 111, but the diverse nature of the many businesses being conducted and the limited nature of the questions presented in any particular case will not permit any one decision which can spell out in detail any single precise test which can be thereafter applied in every case. The basic question is whether, in all the circumstances, the expenditure is

ordinary and appropriate to the conduct of the taxpayer's business. It need only be appropriate and helpful and need not even be habitual or normal in the sense that the same taxpayer will have to make such expenditures often or that they can be reasonably anticipated by a particular taxpayer but only that they are the kind of obligation which would be normal or might be expected to arise in the type of business concerned. Past decisions of lower courts are sometimes helpful to taxpayers and the respondent as illustrative of the principles involved in such a determination but some are (as would be the decision of the Court of Appeals here) confusing and difficult of application. Frequently, at least in the eyes of the respondent, there are no controlling guides. The state of the law is now such that there are insufficient reliable guidelines which are accepted as valid by both taxpayers and the respondent and there continually arises disputes and litigation, as well as different treatment of different taxpayers, all of which should be minimized and avoided if possible. The existing situation will be worsened if the decision of the Court of Appeals herein is not reviewed by this Court.

Frequently the respondent has urged upon the lower courts (and the lower courts have sometimes accepted) unwarranted extensions or variances from the rules set out by this Court, with the result that, in actual application, the law as stated by this Court is not followed. This case is an example. Before the Court of Appeals, the respondent presented this Court's opinion in *Lincoln Savings and Loan Association* v. *Commissioner*, 403 U.S. 345, as holding, and requiring in this and every other case, that any element of compulsion to pay must be completely disregarded. Notwithstanding the statement in the opinion of the Court of Appeals which purports to recognize one of the rules stated by this Court in the *Lincoln* case, i.e., that compulsion does not *per se* make a payment a business expense, it is obvious that the erroneous argument of the respondent was actually adopted by the Court of Appeals, although the error thereof was recognized in the dissenting

Further, there is involved here a decision by the Court of Appeals which is in direct conflict with decisions of this Court respecting the powers of a state over national banks. Since paramount federal law, as stated by this Court on several occasions, forbids any tax or other imposition by a state upon a national bank except as expressly permitted by 12 U.S.C. Section 548, the State of Virginia has no power to require the petitioner to make the payments here involved, and said Virginia statute is void, if such payments are not state taxes as authorized by said federal statute. This Court has also previously indicated, many times, that every part of a statute must be considered in order to determine its true meaning. And every controlling federal statute must be considered in determining the proper meaning and application of a subordinate state statute and, in accordance with the long established rule, a court should indulge itself only in those presumptions which will tend to establish the validity of a state law rather than those which will result in its invalidity. *First Agr. Nat. Bank of Berkshire County* v. *State Tax Commission*, 392 U.S. 339, and the cases therein cited; *Home Savings Bank* v. *Des Moines*, 205 U.S. 503, and the cases therein cited; *Hellmich* v. *Hellman*, 276 U.S. 233. When all the pertinent laws are so considered in this case, it becomes clear that the State of Virginia intended (i) that all obligations imposed by Virginia upon national banks under its tax laws be valid under federal law, (ii) that every national bank in Virginia pay the same amount of tax upon its shares whether or not any of such shares are owned by exempt institutions, and (iii) that the payment procedures adopted by it would provide a convenient method of granting refunds to exempt institutions of the taxes paid by national banks upon shares owned by such exempt institutions. The desirability, on the part of the state, for such procedure for direct refund is obvious since it is less cumbersome and costly to the state, including the local taxing political subdivisions which would otherwise also make a part of each refund to the exempt

institutions. Further, it seems incredible that Congress, in enacting Sections 164(a) and 164(c), would have intended that a bank be entitled to an income tax deduction for state taxes paid by it on shares owned by non-exempt persons when the bank had, but elected not to exercise, the right to reimbursement of such taxes from the shareholder, but be denied a deduction for amounts which the state taxing statute required to be paid to exempt institutions from which the bank could not require reimbursement.

This case probably presents to this Court a greater opportunity than ever before presented in any one case to interpret and clarify the provisions of Sections 162 and 164 of the IRC in a way which will be of immense importance to taxpayers, their advisers, the respondent and the lower courts. On the other hand, if the decision of the Court of Appeals herein is permitted to stand without review by this Court, the difficulty of correctly construing and applying the provisions of the IRC will be greatly increased. Even with respect to factual and legal situations not similar or identical to this case, it is imperative that the questions herein be settled by this Court. The Court of Appeals opinion will undoubtedly be presented in future litigation as standing not only for propositions which have never heretofore been applied or sanctioned but also for some which have been heretofore rejected by the courts, and will, just as surely, be presented as controlling authority against principles of law which have heretofore been generally or universally accepted.

Said opinion casts doubt upon the correctness of numerous Revenue Rulings which have been issued by the Commissioner of Internal Revenue in his administration of the income tax laws.

Research by counsel for the petitioner indicates that twenty other states of the Union impose a tax on shares of national banks, as in Virginia, but it appears that none of the statutes of said twenty other states requires (as Virginia does)

that similar payments be made by national banks to exempt institutions in lieu of direct payment to the state. Counsel has so far been unable to determine which, if any, of said other states permit similar direct payments with a credit against the state tax. Accordingly, it appears that no review by this Court of the federal income tax questions herein presented is likely to arise from a conflict in decisions of such questions among the Courts of Appeal. Yet the determination of the correct federal income tax liabilities of every bank in the State of Virginia, state and national, depends upon a correct decision in this case. Other litigation is in fact presently pending in another division of the United States District Court for the Eastern District of Virginia, involving at least one other national bank, the decision in which will depend upon the final decision here.

It is also imperative that this case be reviewed because of the other, non-income-tax implications of the decision of the Court of Appeals herein. This Court has uniformly held that national banks are subject only to such obligations imposed by the states as Congress expressly permits, that any obligation so permitted may be imposed only to the extent and in the manner authorized, that Congress may prohibit any taxation or other imposition upon national banks by the states and that mere silence by Congress is a prohibition. *First Agr. Nat. Bank of Berkshire County* v. *State Tax Commission*, *supra*. If the payments required by the Virginia taxing statute are not taxes, then one can only conclude that Virginia has exceeded its power in requiring that they be made. [It should be noted that the amendments of 12 U.S.C. 548 made by P.L. 91-156 and P.L. 92-213 do not remove, as to any period after such amendments, any of the questions herein presented.] Not only is serious doubt created as to the power of Virginia to require such payments but also as to the propriety of any action by officials of national banks which permit the payment thereof by the banks. If the required payments are not taxes validly imposed, the officials of a national bank may have no warrant or authority to voluntarily make or permit the making of such

payments, with resulting very serious questions of personal liability if they do so. Any stockholder would undoubtedly have the right to prevent voluntary payments or distributions to shareholders if he were not permitted to share therein. And it is difficult to conceive of any valid argument that any rule of law or any concept of equity or fair play as among shareholders requires that such payments to exempt institutions be made in Virginia when no such law or concept apparently exists in some, and perhaps all, of twenty other states.

Yet, in view of the penalty provided for in the Virginia statute for failure of a bank to comply with the statutory provisions, or if an exempt institution should insist upon the payments provided for in the statute, bank officials may be compelled to seek court guidance before making or failing to make such payments. A logical consequence, then, of the decision of the Court of Appeals would be the institution of one or more suits or actions to squarely put before a court or courts the question of the validity of Section 58-480.1 of the Virginia Code, which at the very least has now been put in grave doubt, with the result that the question will most likely be presented to this Court for final decision. If the statute is subsequently held to impose a valid tax, it will be of no great comfort to the petitioner and other banks in the State of Virginia that their position has been upheld as to the deductibility of such payments for income tax purposes since they will have already been denied valid deductions for valid taxes in computing their federal income tax liabilities for all closed years. Conversely, if the Virginia taxing statute is held to be invalid, the petitioner and other banks in Virginia will not thereafter be entitled to income tax deductions [the rationale of the Tax Court's decision in *Denise Coal Co.* v. *Commissioner*, 29 T.C. 528, would still permit deductions for periods prior to the final determination of invalidity of the Virginia statute] because they will not be required to make any further such payments under said Virginia statute, but such a holding would not remove any of the aforementioned questions respecting the

propriety of the payments theretofore made and would leave unresolved the further question as to whether refunds thereof may, or must, be required from the exempt institutions.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

/s/ T. Howard Spainhour
Attorney for the Petitioner